

# Audit



# Report

OFFICE OF THE INSPECTOR GENERAL

**CAPITALIZATION OF  
WASHINGTON HEADQUARTERS SERVICES  
MILITARY EQUIPMENT**

Report No. 96-194

July 16, 1996

19991026 034

**Department of Defense**

DTIC QUALITY INSPECTED 4

**DISTRIBUTION STATEMENT A**

Approved for Public Release  
Distribution Unlimited

AOI 00-02-0532

**Additional Copies**

To obtain additional copies of this audit report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932.

**Suggestions for Future Audits**

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (703) 604-8939 (DSN 664-8939) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: APTS Audit Suggestions)  
Inspector General, Department of Defense  
400 Army Navy Drive (Room 801)  
Arlington, Virginia 22202-2884

**Defense Hotline**

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to [Hotline@DODIG.OSD.MIL](mailto:Hotline@DODIG.OSD.MIL); or by writing to the Defense Hotline, The Pentagon, Washington, D.C. 20301-1900. The identity of each writer and caller is fully protected.

**Acronym**

WHS

Washington Headquarters Services



**INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
400 ARMY NAVY DRIVE  
ARLINGTON, VIRGINIA 22202-2884**



July 16, 1996

**MEMORANDUM FOR DIRECTOR, WASHINGTON HEADQUARTERS  
SERVICES**

**SUBJECT: Audit Report on the Capitalization of Washington Headquarters Services  
Military Equipment (Report No. 96-194)**

We are providing this audit report for information and use. We performed the audit of the Washington Headquarters Services military equipment account in response to the Chief Financial Officers Act of 1990 and the Federal Financial Management Act of 1994. We considered comments on a draft of this report in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Ms. Mary Lu Ugone, Audit Program Director, at (703) 604-9529 (DSN 664-9529). See Appendix H for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman  
Assistant Inspector General  
for Auditing

## Office of the Inspector General, DoD

Report No. 96-194  
(Project No. 6RF-2001)

July 16, 1996

### The Capitalization of Washington Headquarters Services Military Equipment

#### Executive Summary

**Introduction.** The WHS provides administrative and operational support to more than 40 military and nonmilitary organizations in the Pentagon and throughout the National Capital Region. For FY 1994, WHS reported \$223.6 million in military equipment on its trial balance. Starting with FY 1996, WHS financial data will be included in consolidated DoD financial statements.

**Audit Objectives.** The overall audit objective was to assess WHS internal controls and WHS compliance with laws and regulations. Specifically, the audit was to test accounting transactions to validate capitalization criteria used by WHS to capitalize military equipment. We also evaluated the WHS management control procedures for ensuring that assets were adequately reviewed for DoD capitalization criteria before being recorded in the WHS accounting system.

**Audit Results.** The WHS FY 1994 general ledger military equipment asset account was significantly overstated. As a result, WHS overstated general ledger asset accounts and general ledger equity accounts by at least \$16.3 million in FY 1994. That amount may be significantly larger because WHS used inaccurate analyses of capitalization criteria for the entire \$223.6 million of military equipment that WHS reported on its trial balance.

During the audit, WHS initiated actions to remove \$9.5 million for transactions with unit costs that did not meet capitalization criteria from the general ledger military equipment account 1762 and corrected a flaw in the WHS Allotment Accounting System that improperly recorded equipment procured for other DoD organizations in the WHS military equipment account.

Management controls could be improved by ensuring that military equipment procurements are adequately analyzed to determine whether procured equipment should be capitalized or expensed. Recommendations in the report, if implemented, will result in a more accurate WHS military equipment general ledger balance and improved financial reporting.

**Summary of Recommendations.** We recommend that WHS reduce the amount of its general ledger military equipment account 1762 and its general ledger equity account 3000 by \$6.8 million. We also recommend that WHS establish accounting controls to ensure that military equipment transactions are correctly capitalized and review past transactions and adjust for costs that do not meet DoD capitalization criteria.

**Management Comments.** WHS agreed that the Equipment in Use account was overstated, but did not agree with the amount shown in the report because that amount was based on the FY 1994 WHS trial balance. WHS further stated that it has already taken actions to accurately present the balance in the Equipment in Use account in the WHS financial statements. However, WHS believes it would be too labor intensive to

perform the research necessary to correct the Equipment in Use account for past transactions unless the Under Secretary of Defense (Comptroller) adopts our recommendation, which is made in a separate audit report, to apply one capitalization threshold to DoD assets and to purge all items below that threshold. WHS will establish controls to ensure fixed assets are properly capitalized and accurately reflected in financial statements within 60 days of the Under Secretary of Defense (Comptroller) decision on whether to adopt the recommendations on capitalization.

See Part I for a discussion of management comments and Part III for the complete text of management comments.

**Audit Response.** The WHS actions taken and comments are responsive to our recommendations. No additional comments are required.

# Table of Contents

---

<b>Executive Summary</b>	i
<b>Part I - Audit Results</b>	
Audit Background	2
Audit Objectives	2
Capitalization of Military Equipment at Washington Headquarters Services	3
<b>Part II - Additional Information</b>	
Appendix A. Audit Process	
Scope and Methodology	12
Statistical Sampling Methodology and Results	13
Management Control Program	13
Appendix B. Summary of Prior Audits and Other Reviews	15
Appendix C. Other Matters of Interest	17
Appendix D. Office Furniture, Furnishings, and Fixtures Transactions	18
Appendix E. Contract Services Transactions	19
Appendix F. Computer Equipment Transactions	20
Appendix G. Organizations Visited or Contacted	22
Appendix H. Report Distribution	23
<b>Part III - Management Comments</b>	
Washington Headquarters Services Comments	26

## **Part I - Audit Results**

### Audit Background

Under the authority of the 1958 Defense Reorganization Act, the Secretary of Defense established the Washington Headquarters Services (WHS) on October 1, 1977, as a Department of Defense Field Activity, pursuant to the authority vested under United States Code, title 10. The Director of Administration and Management, Office of the Secretary of Defense, exercises authority, direction, and control over the WHS and serves as Director, WHS.

The WHS provides administrative and operational support to a varied and diverse customer base of more than 40 military and nonmilitary organizations in the Pentagon and throughout the National Capital Region.

Public Law 101-576, the Chief Financial Officers Act of 1990, and Public Law 103-356, the Federal Financial Management Act of 1994, require DoD to prepare annual consolidated financial statements starting with FY 1996. The consolidated DoD financial statements for FY 1996 will include WHS financial data.

For FY 1994, WHS reported \$223.6 million in military equipment on its trial balance. The account represents 42 percent of total WHS assets. WHS will use the trial balance to report financial information for the consolidated DoD financial statements. The Directorate for Budget and Finance is responsible for financial records and reporting for WHS. The Directorate for Information Operations and Reports and the Directorate for Real Estate and Facilities are the WHS property custodians, which are responsible for maintaining property records on WHS assets.

### Audit Objectives

The audit supports the Inspector General, DoD, audit of the FY 1996 DoD-wide financial statements. The overall audit objective was to assess WHS internal controls and WHS compliance with laws and regulations. Specifically, we tested accounting transactions to validate capitalization criteria used by WHS to capitalize military equipment. We did not review performance indicators as announced because the Under Secretary of Defense (Comptroller) has not developed performance indicators for the general funds. See Appendix A for a discussion of the audit scope, statistical methodology, and review of the management control program. See Appendix B for a summary of prior coverage related to the audit objectives.

Appendix C, Other Matters of Interest, discusses the WHS initiative to correct systemic errors in the Washington Headquarters Services Allotment Accounting System.



---

## Capitalization of Military Equipment at Washington Headquarters Services

The WHS military equipment general ledger account was significantly overstated for FY 1994.

The overstatement occurred because WHS did not adequately analyze military equipment procurement transactions to determine whether procured equipment should have been capitalized or expensed.

As a result, WHS overstated a general ledger asset account and its general ledger equity account by at least \$16.3 million for FY 1994. That amount may be significantly larger because WHS did not adequately analyze whether the \$223.6 million of military equipment reported by WHS on its FY 1994 trial balance should have been capitalized. Additionally, the general ledger expense account 6100, Operating/Program Expenses, was understated by a cumulative amount of at least \$16.3 million over 8 years.<sup>1</sup> If not corrected, the management control weaknesses that led to the discrepancies will adversely affect the reliability of financial statements for FY 1996.

### DoD Capitalization Criteria

The general ledger account 1762, Equipment in Use, reflects the acquisition cost of military equipment that meets the DoD capitalization criteria. To meet DoD capitalization criteria, equipment must:

- o have an estimated useful life of 2 years or more, and
- o the acquisition cost must be greater than established expense and investment thresholds.

**Acquisition Cost of DoD Procurements.** The Financial Management Regulation, volume 4, "Accounting Policy and Procedures," January 1995, states that acquisition cost consists of the amount paid for the property, plus the costs of transportation, installation, and other related costs of obtaining equipment and preparing the equipment for use. For any system, the acquisition cost is based on the cost of a complete system rather than on the unit costs of a system's individual components.

---

<sup>1</sup>Expenses are recorded in the applicable expense account in the year the expense occurs, and at the end of that year, the organization's equity account is reduced by the amount of the organization's expense accounts.

## Capitalization of Military Equipment at Washington Headquarters Services

---

**Established Expense and Investment Thresholds.** Table 1 shows the expense and investment thresholds established by Congress since FY 1985.

**Table 1. Expense and Investment Thresholds  
for Military Equipment**

<u>Beginning Fiscal Year</u>	<u>Threshold</u>
1985	\$ 5,000
1992	15,000
1994	25,000
1995	50,000
1996	100,000

### Equipment in Use General Ledger Account

The WHS FY 1994 military equipment general ledger account 1762, Equipment in Use,<sup>2</sup> was overstated by at least \$16.3 million. The overstatement occurred because WHS improperly included the cost of:

- o office furniture, furnishings, and fixtures with unit costs that did not meet DoD capitalization criteria;

- o contract services that were not acquisition costs of equipment; and,

- o computer equipment with unit costs that did not meet DoD capitalization criteria.

**Equipment in Use (Account 1762).** DoD Components use account 1762 to record the capitalized value of DoD military equipment that has been placed in use. WHS uses account 1762 for all military equipment owned and reported by WHS on its trial balance.

WHS categorized the military equipment reported on the FY 1994 trial balance into 17 subclassifications as shown in Table 2. The number of transactions related to each subclassification and the total value of equipment within each subclassification are also shown in Table 2.

---

<sup>2</sup>Labeled as "Military Equipment" on the WHS trial balance.

## Capitalization of Military Equipment at Washington Headquarters Services

**Table 2. WHS FY 1994 Trial Balance Military Equipment  
Account by Object Class**

Object Class No. *	Description	No. of Transactions	Amount
3111	Transportation equipment	6	\$ 171,315
3121	Office furniture, furnishings, and fixtures	178	9,480,970
3122	Office equipment	15	436,848
3123	Reproduction equipment	17	700,851
3124	Automated Data Processing word processing equipment	381	91,387,840
3125	Office storage equipment	2	91,852
3131	Equipment expansions and enhancements	74	31,909,132
3133	Systems networks and gateways	27	2,320,901
3134	Microcomputer-based systems	107	28,860,591
3135	Minicomputer-based systems	8	3,814,462
3136	Mainframe-based systems	1	30,810
3137	Purchased software	46	3,745,856
3138	Prototype system	2	162,157
3141	Communications equipment	15	1,975,958
3151	Audiovisual equipment	12	440,924
3152	Photographic equipment	2	73,437
3159	Other equipment	87	47,979,491
<b>Total</b>		<b>980</b>	<b>\$223,583,395</b>

\*DoD assigns the first two digits of the object classification code; WHS assigns the third and fourth digits. DoD has classified "31" as "Equipment."

### Capitalization Criteria Analysis

WHS did not establish management controls to ensure adequate analysis of military equipment transactions before recording them in the general ledger. WHS analyzed military equipment transactions according to DoD assigned object classification codes; however, those codes were intended and are used for budgetary, not proprietary accounting purposes. WHS assigned 17 subclassifications of equipment as listed in Table 2, but did not use those subclassifications to determine whether DoD capitalization criteria should be based on unit cost, system cost, or total procurement cost.

**Office Furniture, Furnishings, and Fixtures.** We reviewed a sample of eight transactions for office furniture, furnishings, and fixtures that totaled \$789,590. Four of the eight furniture transactions were for "system" furniture, the other four transactions were for standard office furniture. None of those transactions contained assets that individually exceeded the capitalization criteria. We

## Capitalization of Military Equipment at Washington Headquarters Services

---

believe that WHS also inaccurately analyzed and determined that the remaining office furniture, furnishings, and fixtures transactions, valued at a total of \$9.5 million, met capitalization criteria. Furniture must have a unit cost greater than the expense and investment criteria to meet capitalization criteria. Also, furniture components designated as "system" furniture are not part of a whole system any more than standard office furniture. Table 3 lists the sampled furniture transactions. Appendix D discusses the transactions in more detail.

**Table 3. Office Furniture, Furnishings, and Fixtures Analysis**

<u>Transaction Number</u>	<u>Cost (millions)</u>
2	\$ .017
4	.025
6	.036
10	.078
11	.101
13	.136
14	.198
15	<u>.199</u>
<b>Total</b>	<b>\$ .790</b>

WHS agreed to take immediate actions to correct those military equipment transactions subclassified as office furniture, furnishings, and fixtures. Those corrective actions are discussed later in this report in the section titled Corrective Actions Taken as a Result of the Audit.

**Contract Services Included in Acquisition Cost.** Account 1762, Equipment in Use, included contract services, valued at about \$5.7 million, which did not meet the definition of equipment acquisition cost.

Six transactions were for contract services or included contract services that did not meet the definition of military equipment acquisition cost. Table 4 identifies the sampled transactions, and Appendix E discusses the transactions in more detail.

## Capitalization of Military Equipment at Washington Headquarters Services

**Table 4. Sampled Transactions for Contract Services**

<u>Contract Transaction Number</u>	<u>Total Contract Services (millions)</u>
22	\$ .637
23	.677
29	.950
34	1.500
37	.341
39	<u>1.600</u>
<b>Total</b>	<b>\$5.705</b>

**Computer Equipment Procurements.** Account 1762, Equipment in Use, included computer equipment procurements valued at about \$1.1 million with unit costs that did not meet DoD capitalization criteria. Appendix F discusses the transactions in more detail.

**Stand-Alone Computers.** Although the Financial Management Regulation, volume 4, provides special criteria for capitalizing the total system cost of a computer system, four transactions totaling \$663,882 for computer procurements did not meet the DoD definition of a computer system. The computers are designed to be used as independent units, and WHS did not plan to create a computer network using the computers. Table 5 lists the transactions.

**Table 5. Transactions and Costs for Stand-Alone Computers**

<u>Transaction Number</u>	<u>Cost (millions)</u>
3	\$ .022
18	.256
19	.262
37	<u>.124</u>
<b>Total</b>	<b>\$.664</b>

**System Additions.** Four transactions, totaling \$421,438, involved additions to existing systems. Financial Management Regulation, volume 2A, "Budget Presentation and Formulation," May 1994, states that when additions are made to a system, only the additional equipment procurement costs should be used to determine capitalization criteria. Table 6 lists the system additions that alone do not meet the DoD definition of a computer system.

## Capitalization of Military Equipment at Washington Headquarters Services

---

**Table 6. Transactions for Computer System Additions**

<u>Transaction Number</u>	<u>Cost (millions)</u>
1	\$ .015
9	.075
17	.247
37	<u>.85</u>
<b>Total</b>	<b>\$ .422</b>

WHS needs to analyze computer equipment procurements to determine whether a computer system, stand-alone computers, or additions to computer systems are being procured. The expense and investment threshold for capitalizing military equipment should be based on the total system cost for computer systems, on unit costs for stand-alone computers, and on unit costs for additions to computer systems, unless the addition qualifies as a computer system separate from the system to which it is being added. If the addition qualifies as a computer system, then the expense and investment threshold should be based on the total system cost.

### Effects on WHS General Ledger Account Balances

The FY 1994 overstatement of at least \$16.3 million in account 1762, Equipment in Use (asset account), consisted of:

- o \$9.5 million for office furniture, furnishings, and fixtures procurements;
- o \$5.7 million for contract services procurements; and,
- o \$1.1 million for nonsystem and additional computer procurements.

The \$16.3 million should have been charged to one of the 6100 series of operating and program expense accounts:

- o account 6121, Supplies and Materials,
- o account 6122, Equipment-Not Capitalized, or
- o account 6120, Other Services.

Because expense accounts are recorded and closed the year transactions occur, the summary account 6100, Operating and Program Expenses, was understated in the WHS general ledger every year from FYs 1987 through 1994. The cumulative total of expense account understatements from FYs 1987 through 1994 totaled at least \$16.3 million.

## **Capitalization of Military Equipment at Washington Headquarters Services**

---

Further, at the end of each fiscal year, expense accounts are subtracted from equity account 3000, Equity, which reduces the equity account by the amount of annual expenses. Therefore, the FY 1994 WHS equity account 3000, Equity was also overstated in the WHS general ledger by at least \$16.3 million.

WHS needs to more comprehensively analyze military equipment procurements before recording the procurements in the military equipment general ledger account 1762. Also, WHS needs to make adjusting entries to its general ledger to reduce the military equipment general ledger account 1762 and the equity general ledger account 3000 by the amount the general ledger is overstated.

### **Conclusion**

Our sample of 40 military equipment transactions, showed that 20<sup>3</sup> transactions either wholly or partly should not have been capitalized. We believe that a more comprehensive WHS analysis of military equipment transactions could also show that a significant number of the 980 transactions that constituted the \$223.6 million in the WHS military equipment account should have been expensed rather than capitalized.

### **Corrective Actions Taken as a Result of the Audit**

On April 23, 1996, WHS initiated actions to reclassify \$9.5 million for furniture procurements as an expense rather than military equipment because the furniture components did not individually meet the capitalization threshold. The System Manager of the WHS Allotment Accounting System/WHS Budget and Finance Manager<sup>4</sup> agreed that the capitalization criteria for all military equipment transactions that were subclassified as office furniture, furnishings, and fixtures should be based on unit cost. Therefore, he took actions to review all office furniture, furnishings, and fixtures transactions within the WHS military equipment account and expensed those transactions with unit costs that did not meet DoD capitalization criteria. The manager also took action to ensure that office furniture, furnishings, and fixtures transactions are no longer automatically recorded by the WHS Allotment Accounting System as capital assets.

---

<sup>3</sup>Adding the transactions in each table will equal 22 transactions, but transaction number 37 is included in Tables 4, 5, and 6.

<sup>4</sup>One individual at WHS is both the System Manager of the WHS Allotment Accounting System and the WHS Budget and Finance Manager.

## **Recommendations, Management Comments, and Audit Response**

**We recommend that the Director, Washington Headquarters Services:**

- 1. Reduce the amount of FY 1994 general ledger asset account 1762, Equipment in Use, by \$6.8 million by making appropriate accounting entries.**
- 2. Reduce the amount of FY 1994 general ledger equity account 3000, Equity, by \$6.8 million by making appropriate accounting entries.**
- 3. Establish appropriate accounting controls to ensure that military equipment procurements are correctly capitalized before recording procurement transactions in the general ledger.**
- 4. Review past military equipment transactions and adjust the costs that do not meet DoD capitalization criteria.**

**Management Comments.** WHS partially concurred with Recommendations 1., 2., and 4. WHS stated that although it agreed that the Equipment in Use account is overstated, making appropriate accounting entries based on numbers in the 1994 trial balance would require extensive research and would be very labor intensive. However, if the Under Secretary of Defense (Comptroller) adopts our recommendation in another Inspector General, DoD, draft audit report to apply one capitalization threshold to DoD asset accounts and to purge all items valued below that threshold for the purpose of financial reporting, then the research efforts would be drastically reduced. WHS has already taken actions to accurately present the amount of Equipment in Use in its financial statements.

WHS concurred with Recommendation 3. and will establish appropriate controls to ensure that fixed assets are properly capitalized and presented accurately in financial statements within 60 days of a decision by the Under Secretary of Defense (Comptroller) on whether to adopt the recommendations regarding the capitalization threshold.

**Audit Response.** WHS actions and comments are responsive. Therefore, no additional comments are required.



## **Part II - Additional Information**

---

## Appendix A. Audit Process

### Scope and Methodology

**Financial Records Reviewed.** To determine the adequacy of the financial information WHS reported for FY 1994, we reviewed WHS financial records, which included:

- o the report on financial position;
- o the FY 1994 trial balance;
- o the report on cash flow;
- o the report on reconciliation;
- o the report on budget execution;
- o the yearend closing statement; and
- o the chart of accounts for the general ledger.

**Property, Plant, and Equipment Account Selected for Testing.** Of the financial records listed, we determined that WHS uses the trial balance as the basis of financial reporting for WHS. The Plant, Property, and Equipment account represents 42 percent of the total assets WHS reported on its trial balance for FY 1994. Therefore, we judgmentally selected the Plant, Property, and Equipment account, which is shown as military equipment on the trial balance, for testing. We tested the Plant, Property, and Equipment account procurement transactions to determine whether procured assets should have been capitalized or expensed.

**Use of Computer-Processed Data.** To achieve the audit objectives, we extensively relied on computer-processed data in the Washington Headquarters Services Allotment Accounting System. We did not find errors that would preclude use of the computer-processed data to meet the audit objectives or that would change the conclusions of the report.

**Audit Period, Standards, and Locations.** We performed this financial-related audit from October 1995 to March 1996 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the

Inspector General, DoD. Accordingly, we included tests of management controls considered necessary. Appendix G lists the organizations we visited or contacted.

## Statistical Sampling Methodology and Results

The audit used a stratified random sampling plan developed by the Quantitative Methods Division, Office of the Inspector General, DoD. The universe for the Plant, Property, and Equipment account consisted of a total of 980 transactions with a total value of \$224 million. Because of the wide variation in the values of individual transactions, we stratified the universe into four strata based on total value of the individual transactions as shown in the table below.

### Universe of Transactions Representing the Plant, Property, and Equipment Account

<u>Stratum</u>	<u>Range (\$ in thousands)</u>	<u>Population</u>	<u>Total Value Reported</u>
I	\$ 0 to 50	493	\$ 13,780,029
II	\$50 to 100	168	11,906,869
III	\$100 to 500	232	51,299,126
IV	> \$500	87	146,597,370
<b>Total</b>		<b>980</b>	<b>\$223,583,394</b>

We selected a random sample of 87 transactions representing assets with a value of \$73 million. Due to a lack of financial transaction documentation on file at WHS, we were able to review only 40 transactions. Therefore, we did not project our results.

## Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

**Scope of Review of the Management Control Program.** We reviewed the adequacy of the WHS management controls over financial statement reporting for the Washington Headquarters Services Allotment Accounting System.

## Appendix A. Audit Process

---

Specifically, we reviewed the management controls over reporting transactions for the Plant, Property, and Equipment account. We also reviewed the results of any self-evaluation of those management controls.

**Adequacy of Management Controls.** We identified a material management control weakness for WHS as defined by DoD Directive 5010.38. Management controls for the Washington Headquarters Services Allotment Accounting System were not adequate to ensure that assets were adequately reviewed for DoD capitalization criteria before being recorded in the accounting system. Recommendation 3., if implemented, should improve WHS accounting and financial reporting for the Plant, Property, and Equipment account. A copy of the report will be provided to the senior official responsible for management controls in the Office of the Secretary of Defense.

**Adequacy of Management's Self-Evaluation.** The WHS acknowledges that property accountability is a condition that has not been corrected, but has not reported property accountability as a material weakness in its Annual Statement of Assurance.

---

## **Appendix B. Summary of Prior Audits and Other Reviews**

The following reports present issues that affect financial data collections, analysis, and reporting for the WHS General Fund financial statements.

### **Office of the Inspector General, DoD Reports**

**Inspector General, DoD, Report No. 94-156, "Pentagon Reservation Maintenance Revolving Fund Financial Statements for FY 1993," June 30, 1994.** The audit resulted in an adverse opinion on the financial statements. The statements do not present fairly the Fund's financial position, results of operations, cash flows, or budget and actual expenses in accordance with Office of Management and Budget Bulletin No. 94-01 and DoD guidance. The audit identified material weaknesses in the system of controls over implementing the accrual method of accounting. Management controls did not ensure that financial transactions were recorded as they occurred, or, if necessary, adjusted upon receipt of more accurate information. None of the material weaknesses identified during the audit were noted in the WHS Annual Statement of Assurance. The audit cited instances of noncompliance with laws and regulations that materially affected the reliability of the Fund's Principal Statements. WHS had delays in receiving information due to timing differences in the financial process. WHS had not complied with provisions of DoD and Office of Management and Budget guidance.

WHS management disagreed with many of the issues and provided additional information regarding other issues. WHS believed that the financial statements did not adversely affect the organization's ability to effectively control and manage its resources and ensure reliable and accurate financial information to manage and evaluate operational performance.

**Inspector General, DoD, Report No. 94-INS-07, "Washington Headquarters Services," June 20, 1994.** The report states that the WHS planning process did not ensure the best use of available resources and did not provide adequate policies and procedures to ensure that DoD financial management policies are followed. WHS needs to develop and use performance measures, improved management controls, and oversight mechanisms to routinely measure and evaluate the effectiveness and efficiency of the organization. The report recommends that the Director, WHS:

- o develop policies and procedures to improve supply management and accountability and direct the development of plans and procedures to improve property accountability,

- o establish management policies and procedures to ensure that fund managers comply with statutory and regulatory requirements,

## **Appendix B. Summary of Prior Audits and Other Reviews**

---

- o develop a management process to proactively solicit customer feedback concerning the quality of WHS support, and

- o develop improved workload measurement mechanisms and establish procedures to monitor closely and control all overtime work.

In its response WHS:

- o stated that WHS has a long-range plan that projects staffing needs,

- o agreed to provide reports to serviced organizations reflecting open commitments for all expiring appropriations, and

- o stated that WHS had been soliciting customer feedback for some time by using customer surveys.

---

## **Appendix C. Other Matters of Interest**

The WHS has taken the initiative to correct systemic errors in the WHS Allotment Accounting System. The audit found 20 transactions, totaling \$1.9 million, that were designated as reimbursable transactions. The reimbursable transactions were for procurements made by the WHS that were for and funded by other DoD organizations. The reimbursable transactions should not have been included in the WHS military equipment account. The System Manager of the Washington Headquarters Services Allotment Accounting System had identified and corrected the system flaw before we informed him of the condition.

---

## **Appendix D. Office Furniture, Furnishings, and Fixtures Transactions**

We reviewed eight military equipment transactions subclassified by WHS as office furniture, furnishings, and fixtures. WHS improperly capitalized the eight transactions based on total procurement cost instead of the unit cost of each furniture component procured. All eight transactions were funded using Operation and Maintenance funds. The transactions are summarized below.

**Transaction Number 2.** In FY 1991, the WHS Directorate for Real Estate and Facilities-Support Services Division procured system furniture totaling \$17,058 from the Trendway Corporation. The system furniture consisted of 59 separate line items.

**Transaction Number 4.** In FY 1991, the WHS Directorate for Real Estate and Facilities-Support Services Division procured console assemblies totaling \$24,505 from the AMCO Engineering Company. The console assemblies had a unit cost of about \$1,296 each.

**Transaction Number 6.** In FY 1991, the WHS Directorate for Real Estate and Facilities-Support Services Division procured system furniture totaling \$35,964 from the Haworth Corporation.

**Transaction Number 10.** In FY 1993, WHS procured system furniture totaling \$78,000 from Knoll North America, Incorporated, on a reimbursable basis for the Office of the Under Secretary of Defense (Comptroller).

**Transaction Number 11.** In FY 1993, the WHS Directorate for Real Estate and Facilities-Support Services Division procured various office furniture including desks, bookcases and credenzas that totaled \$100,604 for various WHS activities.

**Transaction Number 13.** In FY 1994, the WHS Directorate for Real Estate and Facilities-Support Services Division procured various office furniture including desks and credenzas that totaled \$135,891 for various DoD activities.

**Transaction Number 14.** In FY 1994, the WHS Directorate for Real Estate and Facilities-Support Services Division procured various office furniture that totaled \$198,476 for various DoD organizations.

**Transaction Number 15.** In FY 1993, the WHS Directorate for Real Estate and Facilities-Support Services Division procured system furniture that totaled \$199,093 from Herman Miller, Incorporated. The system furniture consisted of 53 separate line items.



---

## Appendix E. Contract Services Transactions

We reviewed six military equipment transactions that were for or contained contract services. WHS improperly capitalized the cost of the contract services as a part of the acquisition cost of the military equipment. The transactions are summarized below. Transaction number 37 is also included in Appendix F under both stand-alone computers and computer system additions.

**Transaction Number 22.** In FY 1993, WHS sent \$636,837 to the U.S. Army Electronics Proving Ground on a reimbursable basis to develop an electronic data dictionary tool. WHS subclassified this procurement as other equipment, but the development of a software tool should be regarded as a contract service and not as the procurement of military equipment.

**Transaction Number 23.** In FY 1993, WHS sent \$676,919 to Tinker Air Force Base to supply the funds to GTE Government System Corporation for engineering support. WHS subclassified this procurement as microcomputer-based systems, but the procurement is for contract services, not military equipment.

**Transaction Number 29.** In FY 1991, WHS sent \$950,000 to the National Science Foundation to support simulation design for system supportability and human factors. WHS subclassified this procurement as other equipment, but the procurement is for contract services, not military equipment.

**Transaction Number 34.** In FY 1991, WHS sent \$1.5 million to Sytex Incorporated and The BETAC Corporation through the Defense Information Systems Agency for systems analysis and engineering support. WHS subclassified this procurement as automated data processing and word processing equipment, but the procurement is for contract services, not military equipment.

**Transaction Number 37.** In FY 1993, WHS sent \$2.2 million to Government Micro Resources, Incorporated, for computer systems, notebook computers, software maintenance, and computer training courses. The contract services for software maintenance and computer training courses totaled \$341,278. (This procurement is also listed in Appendix F under stand-alone computers and additional computers.) WHS subclassified this procurement as microcomputer-based systems, but more than one-fourth the cost should not have been capitalized.

**Transaction Number 39.** In FY 1990, WHS sent \$2.8 million to GTE Government Services Corporation for computer systems and engineering support. The engineering support portion of this transaction cost \$1.6 million and consisted of application development, program analytical support services, technical engineering support, and system engineering support. WHS subclassified this procurement as microcomputer-based systems, but more than half the cost was for contract services.

---

## **Appendix F. Computer Equipment Transactions**

We reviewed seven transactions that involved computers that either were not part of a system or were additions to existing computer systems. WHS improperly capitalized the transactions as if they were for computer systems and the total procurement cost of each transaction was the computer system cost. Three of the seven transactions were funded with Operation and Maintenance funds, and four transactions were funded with Other Procurement funds. The transactions are summarized below.

### **Stand-Alone Computers**

**Transaction Number 3.** In FY 1991, WHS procured six personal computers with peripheral equipment from Zenith Data Systems at a total procurement cost of \$21,838. WHS subclassified this procurement as automated data processing and word processing equipment.

**Transaction Number 18.** In FY 1991, WHS procured 44 personal computers with peripheral equipment from AT&T at a total procurement cost of \$255,570. WHS subclassified this procurement as microcomputer-based systems.

**Transaction Number 19.** In FY 1990, WHS procured 100 Comtex personal computers with peripheral equipment from Electronic Data Systems at a total procurement cost of \$262,154. WHS subclassified this procurement as automated data processing and word processing equipment.

**Transaction Number 37.** In FY 1993, WHS sent \$2.2 million to Government Micro Resources, Incorporated, for computer systems, notebook computers, software maintenance, and computer training courses. The value of the notebook computers on this contract totaled \$124,320. (This procurement is also listed in Appendix E under contract services.) WHS subclassified this procurement as microcomputer-based systems, but more than one-fourth the cost should not have been capitalized.

### **Computer System Additions**

**Transaction Number 1.** In FY 1990, WHS procured additional computer hardware and software components from Electronic Data Systems at a total procurement cost of \$15,193. WHS subclassified this procurement as automated data processing and word processing equipment.

## Appendix F. Computer Equipment Transactions

---

**Transaction Number 9.** In FY 1990, WHS procured updated computer hardware and software from IBM and Zenith Data Systems at a total procurement cost of \$74,629. WHS subclassified this procurement as automated data processing and word processing equipment.

**Transaction Number 17.** In FY 1991, WHS procured replacement personal computers from Unisys Corporation at a total procurement cost of \$246,630. WHS subclassified this procurement as automated data processing and word processing equipment.

**Transaction Number 37.** In FY 1993, WHS sent \$2.2 million to Government Micro Resources, Incorporated, for computer systems, notebook computers, software maintenance, and computer training courses. The Government modified the contract in FY 1994 to procure additional computers totaling \$84,986. (This procurement is also listed in Appendix E under contract services.) WHS subclassified this procurement as microcomputer based systems, but more than one-fourth the cost should not have been capitalized.

---

## **Appendix G. Organizations Visited or Contacted**

### **Office of the Secretary of Defense**

Under Secretary of Defense for Acquisition and Technology, Arlington, VA  
Under Secretary of Defense for Policy, Arlington, VA  
Under Secretary of Defense (Comptroller), Arlington, VA  
Acquisition/Logistics Systems Integration, Columbus, OH  
Washington Headquarters Services, Arlington, VA

### **Other Defense Organizations**

Defense Finance and Accounting Service, Defense Accounting Office, Washington  
Headquarters Services, Arlington, VA

---

## **Appendix H. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense (Comptroller)  
Deputy Chief Financial Officer  
Deputy Comptroller (Program/Budget)  
Director for Accounting Policy  
Assistant to the Secretary of Defense (Public Affairs)  
Director, Washington Headquarters Services  
Director, Defense Logistics Studies Information Exchange

### **Department of the Army**

Auditor General, Department of the Army

### **Department of the Navy**

Assistant Secretary of the Navy (Financial Management and Comptroller)  
Auditor General, Department of the Navy

### **Department of the Air Force**

Assistant Secretary of the Air Force (Financial Management and Comptroller)  
Auditor General, Department of the Air Force

### **Defense Organizations**

Director, Defense Contract Audit Agency  
Director, Defense Logistics Agency  
Director, National Security Agency  
Inspector General, National Security Agency  
Inspector General, Defense Intelligence Agency

## **Non-Defense Federal Organizations and Individuals**

Office of Management and Budget  
Technical Information Center, National Security and International Affairs Division,  
General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations  
Senate Subcommittee on Defense, Committee on Appropriations  
Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
House Committee on Appropriations  
House Subcommittee on National Security, Committee on Appropriations  
House Committee on Government Reform and Oversight  
House Subcommittee on National Security, International Affairs, and Criminal  
Justice, Committee on Government Reform and Oversight  
House Committee on National Security

## **Part III - Management Comments**

# Washington Headquarters Services Comments



DEPARTMENT OF DEFENSE  
WASHINGTON HEADQUARTERS SERVICES  
1155 DEFENSE PENTAGON  
WASHINGTON, DC 20301-1155



20 JUN 1996

MEMORANDUM FOR DoD INSPECTOR GENERAL  
DIRECTOR, READINESS AND OPERATION SUPPORT

SUBJECT: Audit Report on the Capitalization of Washington Headquarters Services  
Military Equipment (Project No. 6RF-2001)

The subject draft audit report has been reviewed and the following comments are provided as per your request.

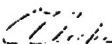
WHS partially concurs with recommendations 1, 2, and 4. While we agree that the Equipment in Use account is overstated, we do not agree on the amount. As stated in the audit report, WHS has taken aggressive actions to more accurately present the amount of Equipment in Use in its financial statements. However, to "make appropriate accounting entries" as stated in the audit report based on numbers presented in a Fiscal Year 1994 trial balance would require extensive research and be very labor intensive.

There is another draft audit report on the Capitalization of Fixed Assets (Project No. 6RA-2014.01) that recommends that one capitalization rule apply to DoD asset accounts, and that all items valued below that threshold be purged for the purpose of financial reporting. We strongly concur with that recommendation, adoption of which would drastically minimize the amount of work required to adhere to the recommendations presented in the subject draft report on Project No. 6RF-2001.

WHS concurs with recommendation 3 of the subject audit report. Based on the adoption/rejection of the recommendation in the audit report on Project No. 6RA-2014.01, WHS will establish appropriate controls within 60 days of that decision to ensure that fixed assets are properly capitalized and presented accurately in financial statements.

My point of contact for this audit report is Mr. William Bader who can be reached at 703-614-0971.

We appreciate the opportunity to provide these comments.

  
D. O. Cooke  
Director





## **Audit Team Members**

This report was prepared by the Readiness and Operational Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

Thomas F. Gimble  
Salvatore D. Guli  
Mary Lu Ugone  
Timothy E. Moore  
Richard Vasquez  
Nancy C. Cipolla  
Cristina Maria H. Giusti

## INTERNET DOCUMENT INFORMATION FORM

**A . Report Title:** Capitalization of Washington Headquarters Services  
Military Equipment

**B. DATE Report Downloaded From the Internet:** 11/24/99

**C. Report's Point of Contact: (Name, Organization, Address, Office  
Symbol, & Ph #):** OAIG-AUD (ATTN: AFTS Audit Suggestions)  
Inspector General, Department of Defense  
400 Army Navy Drive (Room 801)  
Arlington, VA 22202-2884

**D. Currently Applicable Classification Level:** Unclassified

**E. Distribution Statement A:** Approved for Public Release

**F. The foregoing information was compiled and provided by:**  
DTIC-OCA, Initials: \_\_VM\_\_ Preparation Date 11/24/99

The foregoing information should exactly correspond to the Title, Report Number, and the Date on the accompanying report document. If there are mismatches, or other questions, contact the above OCA Representative for resolution.

~~19991126 034~~